Nos. 20,391, 20,392 and 20,393

IN THE

United States Court of Appeals

For the Ninth Circuit

DONALD SCOTT, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent*.	No. 20391
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ESTATE OF BURT EDSALL, Deceased, MARY E. EDSALL, Executrix, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent*.	No. 20393

Appeal from the Judgment of the Tax Court of the United States
Honorable Craig S. Atkins, Judge

PETITIONERS' OPENING BRIEF

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JURISDICTION

This is an appeal, or petition of review, from the decision of the Tax Court of the United States up-

holding a determination by the Commissioner of Internal Revenue of estate tax deficiency in the Estate of Raymond R. Scott, deceased.

Petitions of Redetermination were timely filed with the Tax Court of the United States on May 28, 1963, for review of the Decision of the Commissioner of Internal Revenue. (Trans. of Rec. pages 1 and 10.) A Petition of Review of the three cases herein consolidated was timely filed before this Court on August 5, 1965 (Trans. of Rec. pages 160 and 176), pursuant to Internal Revenue Code, Section 7483. This Court has jurisdiction to review the judgment of the Tax Court under and by virtue of Section 7482 of the Internal Revenue Code.

STATEMENT OF THE CASE

The following facts were submitted by stipulation before the Tax Court:

The decedent, Dr. Raymond R. Scott, a resident of California, died testate on December 1, 1958. His wife, Ruth Scott, died testate on October 28, 1957. Sometime prior to decedent's marriage to Ruth Scott on June 11, 1928, he took out two (2) life insurance policies on his own life. After their marriage, and while living in California, the decedent purchased with community funds eight (8) more insurance policies on his life. After their marriage all premiums paid on all policies were from community funds. (Trans. of Rec. pages 55-56.)

On the day that Ruth Scott executed her Last Will, namely September 20, 1957, she wrote a letter to her two sons, Donald Scott and Robert Scott, concerning the life insurance policies which expressed her concern over continuance of the payment of premiums in the event of her death prior to that of her husband, Dr. Raymond R. Scott. (See Exhibit 4-D to Stipulation of Facts.) (Trans. of Rec. page 98.)

At the time of her death, Ruth Scott was the primary beneficiary on each policy and the Scotts' two children, Donald and Robert, were contingent beneficiaries. (Trans. of Rec. page 56.)

By her Will, Ruth Scott bequeathed all of her community interest in her husband's medical practice to her husband, the decedent, and bequeathed the rest, residue and remainder of her estate to Robert and Donald Scott. (Trans. of Rec. page 94.) Her estate was probated in Fresno County, California. On June 23, 1958, the Estate of Ruth Scott filed a Federal Estate Tax Return with the District Director of Internal Revenue at San Francisco, California. Therein the executor of her estate did not include in the gross estate any amount on account of the life insurance policies.

In 1959, following the decision in *United States v. Stewart* (C.A. 9), 270 F. 2d 894, the executor of the Estate of Ruth Scott agreed with the District Director of Internal Revenue that an amount of $15,946.76 (equal to one-half of the cash surrender value of the life insurance policies as of the date of Ruth Scott's death) was properly includible in her gross estate.

The executor caused to be paid the additional estate tax resulting from such inclusion. (Trans. of Rec. page 56.)

At some time after the death of Ruth Scott, the decedent changed the insurance policies by designating Robert and Donald Scott as primary beneficiaries. (Trans. of Rec. page 57.)

During the period between the death of the decedent's wife and the death of the decedent, premiums of $4,550.68 became due and payable on the policies. Of this amount $2,702.30 was paid by Donald and Robert from that portion of their mother's estate to which they were entitled as legatees. These payments were made by Donald and Robert to prevent the policies from lapsing since the decedent was not in a position to make, or did not make, the necessary payments when they came due. (Trans. of Rec. page 57.)

Two months prior to his death, the decedent borrowed from the life insurance company $11,495.05 on one of the policies of insurance on his life, receiving a check therefor. However, this check was not cashed prior to the decedent's death. (Trans. of Rec. page 57.)

The decedent's estate was probated in Fresno County, California. The decedent's estate tax return was filed on February 29, 1960, with the District Director of Internal Revenue at San Francisco, California. In the estate tax return the executor included in the gross estate the amount of $57,173.43 purporting to represent one-half of the insurance receivable by beneficiaries, other than the decedent's estate,

under policies on the life of the decedent. The respondent determined (and the parties agree) that the amount of insurance so receivable was $115,474.48 (being the face amount of the policies, less amounts borrowed against the policies, including the amount of $11,495.05 borrowed by the decedent two months prior to his death). He then determined that that amount, less, however, the amount of $15,946.76 which had been previously included in the deceased wife's gross estate, or a net amount of $99,527.72, should be included in the decedent's gross estate. Since there had been included in the return on account of the policies an amount of $57,173.43, the net increase determined by the respondent in this respect was $42,-354.29.

In the estate tax return there was included in the gross estate the amount of $5,757.52, representing one-half of the amount borrowed by the decedent, and represented by the check which the decedent had not cashed. In determining the deficiency the respondent included in the gross estate the entire amount of $11,-495.05.

In determining the deficiency the respondent treated the amount of premiums paid by Donald and Robert Scott, $2,702.30, as debts of the decedent and allowed such amount as a deduction in computing the taxable estate.

After the death of the decedent the proceeds of all the insurance policies, as well as the other assets of the decedent's estate, were distributed to the beneficiaries, Donald and Robert Scott.

SPECIFICATION OF ERROR

Petitioners contend that the judgments appealed from are not in accord with law in that the Tax Court erred in holding that all of the proceeds of the ten (10) life insurance policies insuring the life of decedent, Raymond R. Scott, to-wit, $115,474.48, less $15,946.76 previously included in the gross estate of the predeceased spouse, Ruth Scott, were includible in the gross estate of said decedent for federal estate tax purposes, and that the Travelers Life Insurance Company check in the amount of $11,495.05 was wholly includible in said decedent's gross estate; whereas only one-half of the proceeds of the said insurance policies and one-half of said check should have been included in the gross estate of said decedent for estate tax purposes.

ARGUMENT

Petitioners respectfully submit that the law of the State of California is controlling in determining the character, nature and quality of property bequeathed or devised and that the subject life insurance policies were community property of Raymond R. Scott and Ruth Scott and that the Travelers Life Insurance Company check was attributable thereto; petitioners submit that at the time of his death, Raymond R. Scott had incidents of ownership in only one-half of said policies and had only a one-half interest in the subject check, that the community property interest of Ruth Scott in said insurance policies was willed by her and distributed from her estate to her sons,

Donald Scott and Robert Scott, and that her said sons owned one-half of the policies, the check and their entitlements on the date of death of Raymond R. Scott.

I.

The nature, character and quality of devised property for estate tax purposes is dependent upon local law. The question of whether the interest of the wife in her husband's life insurance policies is includible in her estate for tax purposes is controlled and determined by state law.

U. S. v. A. O. Stewart, 270 Fed. 2d 894;

Blair v. Commissioner of Internal Revenue, 300 U. S. 5;

Poe v. Seaborn, 282 U. S. 101;

Lang v. Commissioner of Internal Revenue, 304 U. S. 264.

II.

Under California law, an insurance policy is property. It can be sold, assigned or bequeathed by the owner thereof. Its extrinsic value to the owner is as great as though he held a promissory note of the insurance company payable upon the event of death. It is a chose in action which is satisfied upon payment to the owner thereof—title to the proceeds following title to the policy.

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 98, 243 Pac. 431;

In re Dobbel, 104 Cal. 432, 38 Pac. 87;

California Insurance Code, § 10130;

10 *Cal. Jur.* 2d 695.

In California, when property is acquired during a marriage with community funds, the same constitutes community property. Likewise, the rents, issues and profits of community property are community in character.

California Civil Code, §§ 162, 163 and 164;
Boyd v. Oser, 23 Cal. 2d 613, 621, 145 Pac. 2d 312.

An insurance policy insuring the life of the husband is community property if the premiums have been paid for out of community funds and by the same token, "the proceeds of an insurance policy, the premiums on which have been paid out of community assets, are community property . . ."

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 99, 243 Pac. 431;
New York Life Insurance Co. v. Bank of Italy, 60 Cal. App. 602, 214 Pac. 61;
Union Mutual Life Insurance Co. v. Broderick, 196 Cal. 497, 238 Pac. 1034;
Travelers Insurance Co. v. Fancher, 219 Cal. 351, 26 Pac. 2d 482;
Grimm v. Grimm, 26 Cal. 2d 173, 157 Pac. 2d 841;
Witkin, *Summary of California Law of Community Property,* Section 152(a);
9 *Stanford Law Review* 239.

III.

Prior to 1927 the decisions of the California Courts indicated that the wife had only an "expectancy" in

community assets; however, in 1927 the legislature enacted California Civil Code § 161(a)[1] which has been accepted as establishing that the wife has a "vested" interest in community property. The wife's community property interest, subject to administration, belongs to her and "never did belong to the husband".

Estate of King, 19 Cal. 2d 354, 363, 121 Pac. 2d 716;

Estate of Kelley, 122 Cal. App. 2d 42, 264 Pac. 2d 210.

During her life the wife may sell or assign her community property interests to whomever she may choose. By a like token, she may upon her death devise or bequeath her share of the community property.[2]

> "In the State of California a wife has a one-half interest in community property. It is true the husband retains possession and control of community personal property (Calif. Civil Code 172) but the husband cannot devise the wife's interest

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[1]California Civil Code, § 161(a):

"The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in Sections 172 and 172(a) of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in the community property."

[2]California Probate Code, § 201:

"Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of Sections 202 and 203 of this code."

in community property, either real or personal (California Probate Code § 201, 201.5). *She has such an interest in community property that it is possible for her to will away her portion thereof and thus, at her death, cause a division of the community estate.* (Probate Code §202)". (Emphasis added.)

California Trust Company v. Riddell, 136 Fed. Sup. 7.

IV.

Life insurance policies as items of community property are subject to the same rules pertaining to other community property.

New York Life Insurance Co. v. Bank of Italy, 60 Cal. App. 602, 606, 214 Pac. 61;

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 243 Pac. 431.

"We find nothing in California law which indicates that life policies as items of community property are treated by rules other than or different from those pertaining to community property generally".

U. S. v. A. O. Stewart, 270 Fed. 2d 894.

A life insurance policy occupies no different position than any other form of property and may be sold or assigned by the owner thereof.

See

California Insurance Code, Section 10130;

Esswein v. Rogers, 216 Cal. App. 2d 91, 30 Pac. 2d 738.

If the California statutory law in California Civil Code Section 161(a) and California Probate Code 201 is to be given the meaning which its language requires, those who succeed to the wife's community property interests, by virtue of her Will, must succeed to whatever interest she had at the time of her death; nothing less and nothing more. With respect to each community asset, the legatee acquires equal status and the interest obtained through inheritance is neither diminished nor enlarged. The Tax Court's holding has the effect of causing a severe loss in the process of testamentary disposition. Ruth Scott, at the time of her death, had a community one-half vested interest in the subject policies. If her legatees succeeded to an interest in only one-half the cash surrender value of these policies as the Tax Court holds, something material vanished in the process. The California wife has, without due process, been deprived of her property and the right of testamentary disposition of her entire estate. Such is not the law in this state.

V.

The 1960 decision of the Fourth District Court of Appeals of the State of California in the case of *Estate of Mazie O. Mendenhall, Deceased,* 182 Cal. App. 2d 441, 6 Cal. Rptr. 45, is the only California Court decision directly on point with the case at bar and is fully in accord with petitioners' position. The Court therein states that the wife may by her Will dispose of her interest in community life insurance policies on the life of her husband and that her rep-

resentatives and beneficiaries under her Will succeed to her exact and same position and interest therein.

In *Estate of Mazie O. Mendenhall, supra,* the facts are almost identical as in the subject case. The husband and wife had procured insurance policies on the life of the husband and had paid the premiums thereon out of community funds. The same contractual rights in the policies were given to the husband as in our subject case. There were twelve (12) policies involved. The insurance policies were payable to the husband's estate. The wife died first and under her Will she made certain small and specific bequests. These bequests included the giving to her husband personal effects, home furnishings and an automobile, and also the giving of a $1,000.00 charitable bequest. All of the rest and residue of the estate was left by her to a trust. She made no specific reference in her Will to the life insurance nor to any other specific property except as above mentioned. The question before the Court was whether the deceased spouse could by her Will give to her testamentary trust one-half interest in these insurance policies. The Appellate Court expressly held that *her one-half interest in the insurance policies* went under the provisions of her Will to the trust and, therefore, *"her one-half interest in the insurance policies should have been inventoried as part of her estate"*. As was stated at pages 444 through 447:

> "An insurance policy paid for from community funds is ordinarily community property (Estate of Allie, 50 Cal. 2nd 794, 798 (3) (329 P. 2nd 903); Grimm v. Grimm, 26 Cal. 2nd 173, 175 (1)

(157 Pac. 2nd 841); New York Life Ins. Co. v. Bank of Italy, 60 Cal. App. 602, 606 (214 P. 61); Bazzell v. Endriss, 41 Cal. App. 2nd 463, 464 (1) (107 P. 2nd 49); Cook v. Cook, 17 Cal. 2nd 639, 644 (1) (111 Pac. 2nd 322) . . ."

"Since the insurance premiums here involved were all paid from community funds, and there is no suggestion that any were paid prior to 1927, there is no question but that the wife's interest was 'present, existing and equal' and was a vested interest and that she has equal testamentary power with the husband. (Odone v. Marzocchi, 34 Cal. 2nd 431, 439 (13) (211 P. 2nd 297, 212 P. 2nd 233, 17 A.L.R. 2nd 1109); Horton v. Horton, 115 Cal. App. 2nd 360, 364 (1) (252 Pac. 2nd 397) . . ."

"Mere acquiescence by a dutiful wife to the legal right of the husband to manage and control the community personal property cannot give rise to a presumption that she agreed to surrender her community interest. The fact that he named his estate as beneficiary would give no right of action to the wife until his death. She could, of course, give notice to the insurance company of her community claim, thereby preventing payment of her half interest to a third party, but she could not disturb the policy during the husband's lifetime. (Beemer v. Roher, 137 Cal. App. 293, 294 (5) (30 Pac. 2nd 547); Berniker v. Berniker, supra.) Even after his death, she would still retain her community interest. (New York Life Ins. Co. v. Bank of Italy, supra.) When the husband names his estate as beneficiary, it will not be presumed that he intended to change the character of the property from community to separate (Estate of

Castagnola, 68 Cal. App. 732, 737 (5) (230 Pac. 188); Estate of Wedemeyer, 109 Cal. App. 2nd 67, 71 (6) (240 Pac. 2nd 8).) Since she chose to dispose of her right by Will, her representatives would succeed to her rights . . ."

"We merely hold that the wife's unwritten acquiescence in the naming of the husband's estate as the beneficiary did not deprive her of her community interest therein, and since she did by Will devise her estate to others than her husband, *her one-half interest in the insurance policies should have been inventoried as a part of her estate* for general inheritance tax purposes." (Emphasis added.)

VI.

In the case at bar, the Tax Court erroneously held that the value of the wife's one-half interest in the insurance policies consisted of only the cash surrender value thereof at the time of her death.[3] The confusion arises by a failure of the Tax Court to recognize that an insurance policy is property, the same as a promissory note, contract or chose in action. The confusion arises by a failure to differentiate between the asset and the value of the asset. The discount value of a note is not the note itself. The marketable value of an executory contract is not the contract itself. The

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[3]In valuing the property interest of Ruth Scott in the life insurance policies as of the time of her death for federal estate tax purposes, it was agreed by the executor of Mrs. Scott's estate that an amount equal to one-half of the then existing cash surrender value should be included in the gross estate value. This was considered a fair basis for establishing the value of such interest in line with the decision of *California Trust Company v. Riddell,* supra, and *U. S. v. A. O. Stewart,* 270 Fed. 2d 894.

value of a share of stock is not the interest in the corporation. The fair market value or cash surrender value of an insurance policy is not the insurance contract.

To hold that the wife cannot bequeath her entire community property one-half interest in an insurance policy is abitrary and grossly unjust. If she has no right to bequeath her entire interest, then her husband may effectively deprive her of her property. The insurance policy interest of the wife may have a much greater personal value to her, or to the person to whom she might transfer, assign or bequeath the same, than its then marketable value. To hold that she cannot bequeath her interest in its entirety is to inform her that she must sell, assign or transfer her property, other than by Will, in order to realize the benefits of her labor; and is to inform her that she cannot of her own volition give to her issue the protection and safeguards they deserve. If the wife has no right to bequeath her entire interest, then a husband may with impunity invest the community fortune in insurance policies and thereby deprive her of the fruits of her labor.

CONCLUSION

There is no legal or logical basis upon which one could assert that the wife's community interest in life insurance policies on the life of her surviving husband at the time of her death is merely their value at the time of her demise. This would be a unique theory of making the value of an asset the whole commodity which the deceased may dispose of rather than the asset itself; this would be entirely inconsistent with the law in California or elsewhere, and also, if entertained as to deceased wife's community interest in life insurance contracts on her surviving husband, would contradict the very reasoning by all Courts for including this community interest in the wife's gross estate, which reasoning is that such community interest in the policies are the same as any other community interest and, therefore, subject to the same laws applicable to other community interests on her demise.

Therefore, at the time of the death of Raymond R. Scott, the two sons, Robert and Donald Scott, had the same interest their mother had in the subject life insurance contracts by reason of testamentary gift thereof from Ruth Scott which was received by them under the distribution clause in the Decree of Distribution rendered by the Probate Court in the probate of her Will. Consequently, only one-half of said insurance contracts and half their entitlements are includible in the gross estate of Raymond R. Scott, and since the same principles are applicable to the subject check, only one-half thereof is includible in the gross estate of Raymond R. Scott.

It is respectfully submitted that a reversal of the Tax Court's decision in this case is essential if the logic of the California community property law is to be preserved and if the right of testamentary disposition of community property is to remain a meaningful right to the California wife.

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By ROBERT G. CARTER,
Attorneys for Petitioners.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing is in full compliance with those rules.

ROBERT G. CARTER,
Attorney.

I certify that a copy of the above and foregoing Brief was this date deposited in the United States Mail, postage prepaid, in a cover addressed to Melvin L. Sears, Regional Counsel, U. S. Treasury Department, Internal Revenue Service, Room 628, 447 Sutter Street, San Francisco, California.

Dated at Fresno, California, this 14th day of March, 1966.

ROBERT G. CARTER,
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